

Internal Revenue Service

Number: **200714016**

Release Date: 4/6/2007

2601.00-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:4

PLR-157703-05

Date: NOVEMBER 15, 2006

Legend

Son	=
Daughter	=
Aunt	=
M	=
Husband	=
Wife	=
Family Trust	=
Trust	=
Credit Shelter Trust	=
Exemption Trust	=
State1	=
State 2	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
r	=
s	=
State 1 Law	=

Dear

,

This is in response to your authorized representative's submission dated April 14, 2006, and prior correspondence in which rulings were requested regarding the generation-skipping transfer (GST) tax consequences of transactions involving trusts.

According to the facts submitted and representations made, Wife was the lifetime beneficiary of a testamentary trust, Trust, established under the will of Aunt. Trust became irrevocable on Aunt's death, Date 1, a date prior to September 25, 1985. It is represented that no additions have been made to Trust since Date 1.

Under Trust, commencing on the date of Aunt's death, the trustees will pay Wife all of the net income of Trust for her life. Upon Wife's death, the trustees will transfer all of Trust principal in accordance with any valid provisions contained in Wife's will directing distribution to or among some one or more of her lawful descendants and, to the extent of any default in the effective exercise of such power of appointment, to the then living lawful descendants of Wife, per stirpes, or if no such descendant is then living, then the principal is to be distributed equally to the then living nieces and nephews, and the lawful descendants of any of them who are deceased per stirpes.

On Date 2, Husband and Wife established Family Trust, a revocable trust, with their home and all of their investment assets. Family Trust was restated on Date 3 and amended on Date 4, all dates prior to the deaths of Husband and Wife. Family Trust is governed by the laws of State 1.

Family Trust provides for discretionary income and principal distributions to Husband and Wife during their lives and, upon the death of the first trustor to die, the trustee is to divide the trust estate into two trusts, Credit Shelter Trust and Survivor's Trust.

The first trustor to die was Husband. He died on Date 5. Credit Shelter Trust was funded with Husband's property. It is represented that Credit Shelter Trust is exempt from GST tax by virtue of the allocation of $\frac{1}{2}$ of Husband's GST exemption to the trust and that no additions have been made to Credit Shelter Trust since the death of Husband. Survivor Trust was funded with Wife's property.

Family Trust provides that the trustee of Credit Shelter Trust is to pay to or apply for the benefit of the trustor's children, in equal shares, the entire income of that trust, quarter-annually or more frequently. If the income is insufficient, the trustee, in its discretion, may pay to or apply for the benefit of the trustor's children, so much of the principal of the trust as the trustee deems necessary for their support, health and maintenance. The trustee, in its discretion, may also pay to or apply for the benefit of the surviving trustor, as much of the principal of that trust as the trustee deems necessary for the surviving trustor's support, health, and maintenance. Upon the death of the surviving trustor, Credit Shelter Trust will pass to Exemption Trust, described below.

Family Trust provides that the trustee of Survivor's Trust is to pay to or apply for the benefit of the surviving trustor as much of the income of that trust as the trustee, in the trustee's discretion, determines to be appropriate for the surviving trustor's support,

health, comfort, and well-being and if the income is insufficient, the trustee may also pay to or apply for the benefit of the surviving trustor from time to time as much of the principal of that trust as the trustee, in the trustee's discretion, deems necessary for the surviving trustor's support, health, and maintenance. Further, the trustee shall distribute to the surviving trustor such sums or property from the trust, up to the whole thereof, as the surviving trustor may request in writing at any time or from time to time. Upon the death of the surviving trustor, the trustee shall distribute the trust to one or more persons and entities, including the surviving trustor's estate, either outright or in trust, as the surviving trustor appoints by an instrument in writing, including a will. Any of the trust not effectively appointed shall be divided into two trusts, Exemption Trust and Children's Trust.

Family Trust directs the trustee to divide Exemption Trust into as many equal shares as there are children of the trustors then living and children of the trustors then deceased leaving issue then living. Each share allocated to a living child shall be held as a separate trust. Trustee shall pay to or apply for the benefit of the child, quarter-annually or more frequently, the entire income of the child's trust. If the trustee deems the income of the child's trust insufficient, the trustee may also pay to or apply for the benefit of the child as much of the principal of the child's trust as the trustee, in the trustee's discretion, deems necessary for the child's proper support, health, maintenance, and education.

Upon the death of a child for whom a share of Exemption Trust has been set aside, one-half of the undistributed balance of the child's trust is to be distributed to such one or more persons and entities, other than the child, the child's creditors, the child's estate, or the creditors of the child's estate on such terms and conditions, either outright or in trust, as the child shall appoint and the other half of the child's estate is to be distributed to and among the child's then living issue, in such shares and on such terms and conditions, either outright or in trust, as he or she shall appoint by the last dated instrument delivered to the trustee, including a will (whether or not admitted to probate) specifically referring to and exercising this power of appointment. Any of the child's trust not effectively appointed shall be distributed to the child's then living issue by right of representation, provided however that for all purposes of this trust, the terms "issue" and "child" and children shall exclude M.

Family Trust provides that unless sooner terminated in accordance with other provisions in the trust or the provisions of any trust created by the exercise of any power of appointment conferred by this trust, each trust created under Family Trust and each trust created by the exercise of any power of appointment will terminate twenty-one years after the death of the last survivor of the individual trust beneficiaries who were in being at the time of the death of the first trustor to die.

Wife died on Date 6 in State 1. Wife and Husband were survived by Son and Daughter. In her will, Wife exercised her testamentary limited power of appointment

granted under Trust to appoint one-half of the remainder of Trust to a trust to benefit Son and the other half to a trust to benefit Daughter. The will directs the trustee to pay to or apply for the benefit of each child the entire income of his or her trust in quarter-annually or more frequent payments. If the trustee deems the income insufficient, the trustee may also pay to or apply for the benefit of the child as much of the principal from his or her trust as the trustee, in the trustee's discretion, deems necessary for his or her proper support, health, maintenance, and education. Upon the death of the child, the trust shall be distributed outright to the child's issue, except that M shall not be considered "issue." In Wife's will, Wife appointed Son and Daughter as co-trustees of the trusts to benefit Son and Daughter.

Under Family Trust, Survivor Trust was divided into two trusts, Exemption Trust and Children's Trust. It is represented that Exemption Trust is exempt from GST tax by virtue of the allocation of 5 of Wife's GST exemption to the trust and that no additions have been made to Exemption Trust since the death of Wife. Children's Trust is not a subject of this ruling.

Son and Daughter are co-executors of Wife's estate and co-trustees of Trust and Son is trustee of Credit Shelter Trust and Exemption Trust. On Date 7, Son and Daughter obtained a Court order from Probate Court in State 1 to carry out the terms of Trust and divide Trust into Son's Trust 1 and Daughter's Trust 1 and to carry out the terms of Family Trust and to merge Credit Shelter Trust into Exemption Trust and then to divide Exemption Trust into Son's Trust 2 and Daughter's Trust 2.

Trust which was created under Aunt's will on Date 1, did not contain any rule against perpetuities provision. Wife's will which established Son's Trust 1 and Daughter's Trust 1 did not contain any rule against perpetuities. When Aunt executed her will to establish Trust at her death, State 1 had a common law rule against perpetuities which is essentially the same rule that exists today in State 1. *State 1 Law*. State 1 Law, which was in effect at Wife's death, Date 7, and is currently in effect, provides, in part, that a nonvested property interest is invalid unless when the interest is created, it is certain to vest or terminate no later than 21 years after the death of an individual then alive. Court approved a modification to Son's Trust 1 and Daughter's Trust 1 to add a rule of perpetuities clause that provides that each trust created under Trust and each trust created by the exercise by Wife of any power of appointment under Trust will terminate twenty-one years after the death of the last survivor of the issue of Wife who were living at the death of Aunt. Court also approved a modification to Trust to adopt the administrative trustee provisions of Family Trust to govern Trust because Wife's will did not provide for any administrative trustee provisions for Son's Trust 1 and Daughter's Trust 1.

Family Trust will not be modified. Accordingly, the terms of Son's Trust 2 and Daughter's Trust 2 will be identical to the terms of Family Trust.

Son will serve as trustee for Son's Trusts 1 and 2 and Daughter will serve as trustee for Daughter's Trusts 1 and 2. All trusts for Son and Daughter are irrevocable. State 1 law will apply to Daughter's trusts. The situs of Son's trusts will move from State 1 to State 2. Court order provides that the substantive provisions of Son's Trusts will continue to be governed by State 1 and the administrative provisions of Son's Trusts will be governed by State 2.

The following rulings are requested.

- (1) The division of Trust into Son's Trust 1 and Daughter's Trust 1 will not cause Trust, Son's Trust 1, or Daughter's Trust 1 to become subject to the provisions of chapter 13.
- (2) The modifications to Son's Trust 1 and Daughter's Trust 1 will not cause Trust, Son's Trust 1, or Daughter's Trust 1 to become subject to the provisions of chapter 13.
- (3) The merger of Credit Shelter Trust into Exemption Trust, and the division of Exemption Trust into Son's Trust 2 and Daughter's Trust 2 will not affect the inclusion ratio of Son's Trust 2 or Daughter's Trust 2.
- (4) The change in situs of Son's Trust 1 and Son's Trust 2 will not cause Son's Trust 1 to become subject to the provisions of chapter 13 and will not affect the inclusion ratio of Son's Trust 2.

Rulings # 1 and 2

Section 2601 imposes a tax on every generation-skipping transfer (GST) which is defined under section 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 26.2601-1(b)(1) of the Generation-Skipping Transfer Tax Regulations provides that the provisions of chapter 13 do not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985. Any trust in existence on September 25, 1985 is considered an irrevocable trust.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax will not cause the trust to lose its exempt status.

Section 26.2601-1(b)(4)(i)(D) provides that a modification of the governing instrument of an exempt trust by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the

provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

In section 26.2601-1(b)(4)(i)(E), Example 5, in 1980, Grantor established an irrevocable trust for the benefit of his two children, A and B, and their issue. Under the terms of the trust, the trustee has the discretion to distribute income and principal to A, B, and their issue in such amounts as the trustee deems appropriate. On the death of the last to die of A and B, the trust principal is to be distributed to the living issue of A and B, per stirpes. In 2002, the appropriate local court approved the division of the trust into two equal trusts, one for the benefit of A and A's issue and one for the benefit of B and B's issue. The trust for A and A's issue provides that the trustee has the discretion to distribute trust income and principal to A and A's issue in such amounts as the trustee deems appropriate. On A's death, the trust principal is to be distributed equally to A's issue, per stirpes. If A dies with no living descendants, the principal will be added to the trust for B and B's issue. The trust for B and B's issue is identical (except for the beneficiaries) and terminates at B's death at which time the trust principal is to be distributed equally to B's issue, per stirpes. If B dies with no living descendants, principal will be added to the trust for A and A's issue. The division of the trust into two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the division. In addition, the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13.

Section 26.2601-1(b)(4)(i)(D)(2) provides that a modification that is administrative in nature that only indirectly increases the amount transferred will not be considered to shift a beneficial interest in the trust. In section 26.2601-1(b)(4)(i)(E), Example 10, in 1980, Grantor executed an irrevocable trust for the benefit of Grantor's issue, naming a bank and five other individuals as trustees. In 2002, the appropriate local court approves a modification of the trust that decreases the number of trustees which results in lower administrative costs. The modification pertains to the administration of the trust and does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the modification. In addition, the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the trust will not be subject to the provisions of chapter 13.

Trust, an irrevocable trust, was established on Aunt's death, Date 1, which is prior to September 25, 1985. Accordingly, Trust is considered an irrevocable trust for

purposes of chapter 13 and, therefore, the provisions of chapter 13 do not apply to Trust.

Trust will be divided into Son's Trust 1 and Daughter's Trust 1 pursuant to Wife's exercise of a testamentary limited power of appointment which was granted to Wife under Aunt's will. The proposed modifications to Trust will add a rule against perpetuities provision and administrative provisions to Son's Trust 1 and Daughter's Trust 1. Based upon the facts submitted and representations made, we conclude that the division of Trust into Son's Trust 1 and Daughter's Trust 1 and the modifications to Son's Trust 1 and Daughter's Trust 1 will not shift any beneficial interest in the trusts to a beneficiary who occupies a lower generation than the person or persons who held the beneficial interest prior to the division. In addition, the division and modifications will not extend the time for vesting of any beneficial interest in the trusts beyond the period provided for in the original trust. Accordingly, we rule that the provisions of chapter 13 will not apply to Son's Trust 1 and Daughter's Trust 1.

Ruling #3

Section 2642(a) provides that for purposes of chapter 13, the inclusion ratio with respect to any property transferred in a generation-skipping transfer shall be the excess (if any) of 1 over the applicable fraction determined for the trust from which such transfer is made. The applicable fraction is a fraction the numerator of which is the amount of the GST exemption allocated to the trust and the denominator of which is the value of the property transferred to the trust reduced by certain sums described in section 2642(a)(2)(B)(ii).

Section 2631(a), as it applied in the years at issue in this case, provides that for purposes of determining the inclusion ratio, every individual is allowed a GST tax exemption (adjusted for inflation under section 2631(c)) that may be allocated by the individual (or the individual's executor) to any property with respect to which the individual is the transferor. An allocation, once made, is irrevocable.

It is represented that Husband's executor allocated sufficient GST exemption to Credit Shelter Trust and that Wife's executor allocated sufficient GST exemption to Exemption Trust to give each trust an inclusion ratio of zero. Credit Shelter Trust will be merged into Exemption Trust and then Exemption Trust will be divided into equal shares for Son and Daughter to create Son's Trust 2 and Daughter's Trust 2. The terms of Son's Trust 2 and Daughter's Trust 2 are identical to the original terms of Credit Shelter Trust, as provided in Family Trust. We conclude that the merger of Credit Shelter Trust into Exemption Trust and the division of Exemption Trust into Son's Trust 2 and Daughter's Trust 2 will not affect the inclusion ratio of the resulting trusts. Accordingly, we rule that, assuming sufficient GST exemption was allocated originally to Credit Shelter Trust and Exemption Trust to give each trust an inclusion ratio of zero, Son's Trust 2 and Daughter's Trust 2 will retain inclusion ratios of zero.

Ruling #4

As noted above, Son's Trust 1 is subject to the rules of section 26.2601-1(b)(4)(i). On the other hand, Son's Trust 2 was irrevocable after September 25, 1985 and is exempt from GST tax because sufficient GST exemption has been allocated to the trust. No guidance has been issued concerning changes that may affect the status of trusts that are exempt from GST tax because sufficient GST exemption was allocated to the trust to result in an inclusion ratio of zero. At a minimum, a change that would not affect the GST status of a trust that was irrevocable on September 25, 1985, should similarly not affect the exempt status of such a trust.

In section 26.2601-1(b)(4)(i)(E), Example 4, in 1980, Grantor, who was domiciled in State X, executed an irrevocable trust for the benefit of Grantor's issue, naming a State X bank as trustee. Under the terms of the trust, the trust is to terminate, in all events, no later than 21 years after the death of the last to die of certain designated individuals living at the time the trust was executed. The provisions of the trust do not specify that any particular state law is to govern the administration and construction of the trust. In State X, the common law rule against perpetuities applies to trusts. In 2002, a State Y bank is named as sole trustee. The effect of changing trustees is that the situs of the trust changes to State Y, and the laws of State Y govern the administration and construction of the trust. State Y law contains no rule against perpetuities. In this case, however, in view of the terms of the trust instrument, the trust will terminate at the same time before and after the change in situs. Accordingly, the change in situs does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the transfer. Furthermore, the change in situs does not extend the time for vesting of any beneficial interest in the trust beyond that provided for in the original trust. Therefore, the trust will not be subject to the provisions of chapter 13.

Pursuant to Court order, the situs of Son's Trust 1 and Son's Trust 2 will change from State 1 to State 2. However, by Court order, the substantive provisions of Son's Trusts will continue to be governed by the laws of State 1. Therefore, while there is a change in situs for both of Son's Trusts, the laws governing these trusts does not change.

When Aunt executed her will establishing Trust at her death, State 1 had a common law rule against perpetuities which has since been codified and is currently effective in State 1. *State 1 Law*. State 1 Law provides that a nonvested property interest is invalid unless when the interest is created, it is certain to vest or terminate no later than 21 years after the death of an individual then alive. Son's Trust 1 will be modified to provide that each trust created under Trust and each trust created by the exercise by Wife of any power of appointment under Trust will terminate twenty-one

years after the death of the last survivor of the issue of Wife who were living at the death of Aunt. Accordingly, Son's Trust 1 will terminate at the same time before and after the change in situs. Son's Trust 2 continues to be governed by the laws of State 1 and the trust provisions will not be modified. Accordingly, Son's Trust 2 will terminate at the same time before and after the change in situs. Based upon the facts submitted and representations made, we conclude that a change in situs of Son's Trust 1 and Son's Trust 2 will not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the transfer. Furthermore, the change in situs does not extend the time for vesting of any beneficial interest in the trust beyond that provided for in the original trust. Therefore, we rule that Son's Trust 1 will not be subject to the provisions of chapter 13 and the inclusion ratio of Son's Trust 2 will not be affected by the change in situs.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code. In accordance with the power of attorney on file with this office, a copy of this letter is sent to your representative.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Lorraine E. Gardner
Senior Counsel, Branch 4
(Office of Passthroughs and Special Industries)

CC: Enclosures

Copies of letter for section 6110 purposes